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SUBJECT: BELLWEATHER PROJECT: TAMIL NADU'S MANUFACTURING BOOM

¶1. (SBU) SUMMARY: Two recently announced proposed projects - an almost \$1 billion automobile joint venture between India's Mahindra & Mahindra, Nissan, and Renault and a \$30 million dollar investment by Dell - highlight Tamil Nadu's continued growth as a manufacturing hub. While Tamil Nadu also boasts substantial information technology development, the growth of manufacturing in and around Chennai sets it apart from the rest of South India. Manufacturers locating in Tamil Nadu do so because they can cut costs by leveraging cheap skilled labor and take advantage of the state's comparatively strong infrastructure, including excellent port facilities. But rapid growth could erode the state's competitive advantage as shortages of skilled workers and infrastructure inadequacies emerge. END SUMMARY.

¶2. (SBU) This is another in a series of cables in the bellwether project launched by Mission India's POL and ECON sections in September 2006 to take the economic and political temperature in states over the next year. Previous reports covered Punjab, West Bengal, Gujarat, Uttar Pradesh, and Bihar. Because Tamil Nadu has one of India's most successful and diversified manufacturing economies, Consulate General Chennai officers met with numerous business leaders, government officials, and academics to develop an understanding of the reasons for the state's success as well as the challenges ahead.

CHENNAI: THE DETROIT OF INDIA

¶3. (U) On February 26, 2007, Mahindra & Mahindra, Renault, and Nissan announced a joint venture to produce cars at a new facility spread over 1100 acres to be located in Oraigadem (a suburb of Chennai). The partners plan to invest \$900 million in a facility that will produce a projected 400,000 cars per year. The production will consist mostly of Nissan subcompacts, as well as versions of Renault's Logan platform. Mahindra & Mahindra (the Indian partner) will have the majority equity share in the joint venture, with Renault and Nissan each holding approximately 25 percent. The joint venture expects to commence production in 2009.

¶4. (U) Renault and Nissan will augment the region's already significant automobile industry. Since 1999, Ford Motor Company has operated a facility located in Marimalainagar (another Chennai suburb). The Ford plant has the capacity to produce 50,000 cars per year. It currently produces the Fiesta and the Fusion, which is a hatchback produced primarily for the Indian market. In addition, the company produces knockdown kits for export to Mexico, Brazil, and China. The facility also assembles a limited number of Endeavor sport-utility vehicles for the local market. Hyundai Motors

operates a much larger facility, with a capacity to produce 300,000 cars per year, mostly subcompacts for both the Indian and international markets. Heung Soo Lheem, Managing Director, Hyundai Motor India, told post that Hyundai plans to double the capacity of its Chennai facility to make it Hyundai's worldwide hub for small car exports.

¶15. (U) In addition, Mitsubishi and BMW have assembly units in Tamil Nadu that produce smaller numbers of vehicles for the Indian market.

The Mitsubishi and BMW models are very large by local market standards; as such, the production numbers are quite modest compared to the other Chennai automobile plants. BMW's Chennai facility was set up with an investment of over \$26 million and will ultimately have the capacity to produce between 1,500 and 1,700 cars annually. BMW's first car rolled off the assembly line on March 29.

¶16. (U) International component suppliers, following closely behind the major manufacturers, significantly multiplied the effect of the original Ford and Hyundai investments. Visteon, a former Ford subsidiary, and now the company's Tier-1 vendor, followed Ford to Tamil Nadu. With its \$100 million facility, Visteon supplies both Ford and Hyundai with climate control and instrumentation systems. TRW in partnership with Rane, an Indian automotive component manufacturer, produces power steering and brake systems that are used as original equipment by major automotive brands throughout the world. Ford and Nissan have gone a step further, setting up captive units in Chennai that provide design and back office support for their worldwide operations.

¶17. (U) Chennai has a long history as a leader in India's automobile industry. In 1955, Ashok Motors collaborated with British Leyland in setting up a factory in a north Chennai suburb to manufacture trucks and buses under the name Ashok Leyland. In 1962, Standard Motors established a facility to produce the Herald model of cars in a Chennai suburb close to where Ford's plant now stands. T.V.

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Sundram (TVS) Iyengar and Sons, an Indian logistics group, partnered with Lucas of United Kingdom to begin production of electrical subsystems in 1962. Today, TVS is one of India's largest component manufacturers. Much of Chennai's current success in the automotive sector can be attributed to the supply chain that TVS put in place to support Ashok Leyland and Standard Motors.

¶18. (SBU) The success of the automobile sector in Tamil Nadu has the attracted attention of policymakers. In a recent off-the-record roundtable discussion, Union Commerce Minister Kamal Nath described the government's desire to bring manufacturing from its present position of 17% of GDP up to a goal of 25% of GDP within the next decade. Nath said that growth in manufacturing was critical to efforts to include agrarian workers in India's growth story. He specifically cited automobile manufacturing and automobile components as an important success on this front.

NOT JUST CARS: MOBILE PHONES AND PCS MADE IN CHENNAI

¶19. (SBU) Tamil Nadu's influence in New Delhi's corridors of power has helped steer electronic manufacturers to the state. Dayanidhi Maran, Union Minister for Information Technology and Communication, is a member of Tamil Nadu's ruling DMK party. At Maran's urging, mobile phone manufacturer Nokia in April 2005 invested \$150 million in a manufacturing facility at Sriperumbudur (50 kilometers from Chennai). Nokia's investment also attracted seven of its component suppliers to invest in the region. Nokia's printed circuit board supplier, Aspocomp Group Oyj, invested \$70 million. At the same time, Nokia's handset mechanics supplier Perlos Corporation invested \$12 million. Nokia and its suppliers are located in a special economic zone spread over 210 acres, which provides fiscal incentives and allows for considerable flexibility in the hiring of personnel. By December 2006, the facility had shipped 25 million handsets for the booming Indian mobile phone market. Motorola followed in Nokia's wake with an announcement in June 2006 of its plans to invest \$30 million in a facility to produce handsets. The facility will produce low cost handsets for the Indian market.

¶10. (U) Personal computer makers were not far behind. In September 2006, Dell announced plans to invest \$30 million over five years in a manufacturing facility with the capacity to produce 400,000 desktop computers for the Indian market. Construction began in December 2006. Dell's 150 acre plot includes 100 acres set aside for its component manufacturers.

¶11. (U) A month after the Dell announcement, Flextronics, a supplier of sub-systems to major computer and mobile phone manufacturers, announced an additional \$100 million investment in its Chennai operation. Michael Rubin, Flextronics' Director of Business Development, told post in February 2007 that the facility had already begun production of printed circuit boards for mobile phone handsets and had started test runs on lines meant for computer systems. Rubin believes that the company will be ready to supply Dell's operation once it begins production in July 2007. The Flextronics facility uses only 10 of the 250 acres that the company has acquired; it expects some of its own component manufacturers to set up facilities on the remaining land.

SURPRISE! GOVERNMENT FACILITATES BUSINESS DEVELOPMENT

¶12. (SBU) Unlike in some parts of India, business people in Tamil Nadu view the state's government as a positive factor in their investment decisions. Business leaders frequently sing the praises of local government. R. Subramaniam, Secretary General of the Madras Chamber of Commerce, told post that Tamil Nadu's "fantastic" bureaucracy is a large reason why it has been so successful in drawing investment to the state. (NOTE: "Fantastic" is not a word one expects to be used by business to describe Indian governance. Establishing such a positive reputation for governance is quite an accomplishment in an environment where businesses generally see government as harming, not helping, them. END NOTE.)

¶13. (SBU) Tamil Nadu's bureaucracy proactively seeks to smooth the way for investors. The Tamil Nadu Industrial Guidance Bureau acts as the state's investment marketing arm. M. Velmurugan, a dynamic officer of the Indian Economic Service, spearheads the bureau's effort. He makes a compelling case for Tamil Nadu, complete with a slick power point presentation. Velmurugan charismatically and enthusiastically assuages potential investors concerns by providing necessary data, facilitating meetings with government officials, and

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assisting with drafting a memorandum of understanding (MOU). Velmurugan proudly explained to post that his office acts as the single point-of-contact for a prospective investor, holding their hand through the entire process of negotiating the MOU. Rather than dealing with several different state government agencies, the prospective investor works only with the Guidance Bureau. Although other states have similar guidance bureaus, Velmurugan's energy and magnetism are no doubt an important factor in Tamil Nadu's success.

¶14. (SBU) The Guidance Bureau had a plan from the beginning. Velmurugan told post that rather than going "fishing" for industry, Tamil Nadu instead "targeted whales" with the understanding that the small fish would come once Tamil Nadu reeled in the whales. The Guidance Bureau has targeted big names in the manufacturing world, starting with Ford in 1995 (which brought 35 of its vendors along), followed by Hyundai, Nokia, and Dell. Business leaders frequently cite Tamil Nadu's successful courtship of Ford as the defining event in Tamil Nadu's development as a manufacturing center. The Guidance Bureau has attracted 168 investment proposals worth on an average \$50 million per project.

¶15. (SBU) Tamil Nadu has had less trouble with the often quarrelsome issue of land acquisition that has scuttled investments in other parts of India. Under Tamil Nadu's 1997 Acquisition of Land for Industrial Purposes Act the state bureaucracy acts as facilitator, but leaves the bulk of the land price negotiations to be sorted out by the landowners and representatives of foreign investor. Pradeep Yadav, District Collector of Kancheepuram, who

administers Tamil Nadu's most industrialized area, told post that unlike the foreign investors the government was limited by law as to the amount it could pay as compensation. He said that allowing the foreign investor to negotiate the price resulted in a shorter timeline for land acquisition and, more importantly, fewer disputes arising from landowners who feel that they are not sufficiently compensated. Yadav said that the government only intervened in the rare cases when landowners refused to part with their land whatever the price offered.

LOW COST OF LABOR DRIVES GROWTH

¶16. (U) Cost competitiveness, primarily in the cost of labor, is the number one reason that has attracted the likes of Ford, Hyundai, Nokia, Dell, and Flextronics. Nokia and Flextronics estimated that the cost of labor in Tamil Nadu is one-third that of China. The cost advantage is driven by the large educated labor pool and weakness of labor unions. Tamil Nadu produces eighty thousand engineering graduates each year, along with the skilled labor graduates from thousands of polytechnics and industrial training institutes. Companies have the pick of this very large crop: a Ford representative told post that it had received 11,000 applications in response to advertisements for only four vacant engineering positions. The unemployment rate among engineering graduates is between 19% and 22%, allowing companies to pay lower salaries.

¶17. (SBU) Heung Soo Lheem of Hyundai was more explicit, explaining that cheap labor more than makes up for the higher infrastructure and freight costs of production in Tamil Nadu. Hyundai's Alabama facility had to pay the substantial cost of installing air-conditioning throughout the facility. In Tamil Nadu, where the year-round climate is more hot and humid than an Alabama summer, there is no air-conditioning. The Chennai plant works 302 days per year, compared to only 230 days for the Alabama plant. When asked about whether its Tamil Nadu plant employees had a union, or were demanding a union, Mr. Lheem laughed and told post "there is no UAW here." His blunt assessment highlights the fact that employers in Tamil Nadu no longer face the type of labor strife common in the past.

INFRASTRUCTURE ENABLES INDUSTRIAL DEVELOPMENT

¶18. (U) Better governance has also led to better infrastructure, at least relative to the rest of India. Tamil Nadu has a power surplus and a solid electricity distribution network. Arvind Mathew, Managing Director of Ford India, told post that Tamil Nadu had made good on its original promise to Ford that it would ensure sufficient power to the plant. When asked about Ford's back-up generation capacity, Mathew said that Ford had no back-up generators and that none were necessary. Representatives of both Ford and

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Hyundai said that in the last four and a half years, there have been just two power interruptions. Both disruptions were the result of accidents rather than a lack of capacity or distribution capability.

In order to meet Tamil Nadu's promise of uninterrupted power to the Ford and Hyundai facilities, the state has provided dedicated sub-stations for each facility. Each of these substations is connected to two different circuits to minimize the chance of failure. (NOTE: Despite a generally good record of keeping promises, Tamil Nadu dropped the ball on at least one promise it made while courting a potential investor. It promised Ford that it would develop a site for hazardous waste disposal. To date, Tamil Nadu has not done so, leaving Ford to store the waste on its site. Tamil Nadu credibly cites environmental lawsuits as the reason for this failure. END NOTE.)

¶19. (U) Two sea ports, one dedicated to the handling of clean cargoes such as cars and containers, ensure easy access to worldwide markets. Hyundai's Lheem told post that the relative efficiency of the local port played a major role in their decision to turn their

facility into a global export hub. Chennai's excellent rail connectivity ensures inexpensive transportation of cars for the Indian market. Two undersea fiber optic cables connect Chennai to the United States via Singapore and Guam, giving the city the largest bandwidth in all of India at 12 terabits. Connections to south-east Asia and Europe through Chennai's international airport facilitate the flow of inputs and finished products from the electronics industry.

RAPID GROWTH STRAINS CHENNAI'S ADVANTAGES

¶20. (SBU) The rapid pace of growth has stretched Chennai's advantages to the limit. Business leaders say that labor shortages are emerging throughout all segments. These shortages are especially acute in the skilled and management segments. Despite the massive numbers of graduates that Tamil Nadu produces, many are unprepared to be effective employees. Sheila Gandhi, of the National Association of Software and Service Companies, said that only 12% of graduates are actually employable after completing their degrees. Communication skills, in particular, are lacking. Companies are forced to provide "finishing courses" for students coming out of the state's colleges, adding costs and increasing the time before they can begin contributing to the company. (NOTE: Consular officers are struck by the lack of communication skills of even the most qualified Indian student visa applicants. Indian engineering graduates, though proficient in highly technical computer skills, often have never taken an English reading or writing course. A focus on rote memorization rather than critical thinking skills leaves graduates unable to place what they have learned in a broader context. END NOTE.) With labor becoming scarce, wages are increasing. But, to date wage inflation has not offset Tamil Nadu's advantage vis a vis other parts of India or other countries.

¶21. (SBU) Industry analysts fear that power availability in the state could be a problem as demand far outstrips addition of new capacity. They point out that in the last two years capacity expansion has been in the order of hundreds of megawatts, while demand has expanded in the thousands. In addition to power availability, transportation is becoming a concern. Chennai's traffic problem is increasing by the day. The city's already strained roads add at least 600 new vehicles a day. Referring to now legendary traffic jams in India's information technology hub, Tamil Nadu's Secretary for Industries Shaktikanta Das told the American Chamber of Commerce that "We do not want to go the way of Bangalore." The long-awaited expansion of Chennai's airport has been bogged down by controversy over land acquisition. Government officials keep hinting that an announcement on the airport will come soon but it remains stalled.

¶22. (U) Increasing land prices also threaten Chennai's manufacturing growth. Speculative purchases, once uncommon here, follow any announcement of a new industrial project. Cocktail party banter, as in many bubble markets, inevitably turns to the cost of land. Industry and government representatives alike cite rising land prices as a serious problem. Land on the road which links Chennai to Tamil Nadu's industrialized southern districts have increased by fifty percent. The National Highways Authority of India purchased land on the road at \$105 per square foot in March 2006; a year later land from the same plot sold for \$141 per square foot. Increased land costs affect both the cost of establishing a new industrial project, as well as the wage demands of potential workers who must find housing nearby. (NOTE: The Consulate itself

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recently came across the effects of Chennai's real estate bubble when it began the search for a suitable site for the New Consulate Compound. The Consulate was quoted prices of \$2 million to \$4 million dollars per acre. END NOTE.)

GOVERNMENT AND BUSINESS REMAIN CONFIDENT ABOUT FUTURE

¶23. (SBU) COMMENT: Tamil Nadu is unique in South India in having developed a robust manufacturing sector to accompany growth in information technology. Pressures on infrastructure and the state's human resources are no doubt increasing with the state's rapid growth. But government officials and industry associations are working together to develop plans to tackle the problems Tamil Nadu faces -- from developing human resources to untangling traffic problems. Individual business leaders, despite expressing concerns about mounting challenges, remain bullish on Chennai's future. Validating this optimism will require Tamil Nadu to do even better than it has done to date to lay the groundwork for manufacturing in the state. END COMMENT.

¶24. (U) This cable was coordinated with Embassy New Delhi.

HOPPER